IN THE HIGH COURT OF JUDICATURE AT MADRAS

DATED : 22.02.2006

Coram :

THE HONOURABLE MR.JUSTICE P.D.DINAKARAN

AND

THE HONOURABLE MR.JUSTICE P.P.S.JANARTHANA RAJA

Tax Case (Reference) Nos.379 to 382 of 2001
(Reference Nos.309 to 312 of 2001)

M/s.Sujatha Films P. Ltd.,
4, Seshadri Road,
Alwarpet,
Chennai-18. ..Applicant in all cases.

Vs

The Commissioner of Income Tax,
Central-I,
Chennai. ..Respondent in all cases.

Reference under Section 256(1) of the Income Tax Act, 1961 by Income Tax Appellate Tribunal, Madras, 'A' Bench in R.A.Nos.386 to 389/Mds/97 arising out of I.T.A. Nos.1647/M/90, 489/M/91, 2452 & 2453/M/92 for the assessment years 1986-87, 1987-88, 1988-89 and 1989-90 against the Commissioner of Income Tax (Appeals) IV, Madras 34, dated 26.12.1989 and made in ITA.37/89-90/Central Circle I(1)/Madras dated 23.1.1991, made in IT.Appeal Nos.37/90-91/Central.Cir.I(1)/Madras, dated 28.8.1992 made in ITA.No.33/92-93/Cent.Cir.I(1)/Mds, and dated 28.8.1992 made in ITA.No.34/92-93/Cent.Cir.I(1)/Mds against the Order of the Assistant Commissioner, Central Circle I(1), Madras 34 dated 30.3.1989 and 28.3.1990 18.3.1992 & 24.3.1992 made in P.A.No.47-062-CQ-4719/1986-87, 1987-88, 1988-89, 1989-90.

For Appellant : Mr.Srinath Sridevan

For Respondent : Mrs.Pushya Sitaraman

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JUDGMENT

(Judgment of the Court was delivered by P.P.S.Janarthana Raja, J.)

Income Tax Appellate Tribunal, Madras, 'A' Bench, referred the matter under Section 256(1) of the Income Tax Act at the instance of the assessee, for opinion of this Court, raising the following questions of

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law:

1. For the assessment years 1986-87 to 1989-90:
"Whether on the facts and in the circumstances of the case the Tribunal was justified in law in coming to the conclusion that interest at 15% was accruing on the amount of Rs.1,08,50,000/- due to the assessee by one Sri K.L.Srihari, despite the attachment of the loan under section 226(3) of the Income-tax Act, 1961 and despite the agreement between the assessee and the debtor that no interest shall be chargeable or payable on the loan from 1.3.85 and that the same was assessable as the assessee's income according to the system of mercantile accounts followed by it?"

2. For the assessment year 1988-89 only:
"Whether on the facts and circumstances of the case, the Tribunal was correct in law in holding that the return filed by the assessee in response to the notice u/s. 142(1) was a return filed under Section 139(4) and therefore the provisions applicable for determining time limit for completion of assessment was Section 153(1)(b) as amended from 1.4.89?"

2. The facts arising out of the first question of law are as under: The relevant assessment years are 1986-87 to 1989-90. The assessee is engaged in the business of distribution of films. The assessee company advanced a loan of Rs.2,59,50,000/- to one Sri K.L.Srihari. The borrower repaid Rs.1,51,00,000/- on 22.03.84 reducing the balance outstanding to Rs.1,08,50,000/-. On 21.2.1985, the Income Tax Department served a notice u/s 281B of the Act prohibiting the said Sri K.L.Srihari from paying the loan amount and the interest thereon to the assessee and directing him to pay the same to the Income Tax Department towards the tax arrears of the assessee. Later on, the prohibitory order u/s 281B was substituted by an order under Section 226(3). Soon thereafter, the assessee and the debtor decided that no interest would be payable or charged on the loan with effect from 01.03.85. In the books of the borrower, interest was credited to the account of the assessee company for the period upto 31.12.84 only as detailed below. No interest was credited for any period thereafter.

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Interest on Rs.2,59,50,000/- from 01.12.83 to 21.03.84 @ 15%	Rs.12,18,150/-
Interest on Rs.1,08,50,000/- from 22.03.84 to 30.11.84 @ 15%	Rs.11,30,208/-
Interest for 275 days from 01.04.84 to 31.12.84	Rs.12,26,198/-

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The assessee did not receive any part of the above mentioned interest in view of the prohibitory orders and also in particular, no interest was received during the accounting periods relevant for the assessment years and hence, no interest was admitted in respect of this loan for the respective assessment years. Further, it was also explained before the Assessing Officer that the borrower had refused to pay interest as the debt had been attached by the Income Tax Department. The Assessing Officer came to the conclusion that non receipt of interest did not mean that the interest had not accrued to the assessee and it was not payable. Since the assessee was maintaining the accounts on mercantile basis, the Assessing Officer included the accrued interest to the total income of the assessee. Aggrieved by the order, the assessee filed an appeal to the Commissioner of Income Tax (Appeals). The Commissioner of Income Tax (Appeals) rejected the appeal and confirmed the order of the Assessing Officer. Aggrieved by the order, the assessee filed an appeal to the Income Tax Appellate Tribunal. The Income Tax Appellate Tribunal held that, interest in question was includible in the assessable income of the assessee notwithstanding the prohibitory orders and notwithstanding the decision of the assessee and the debtor that no interest would be payable or charged after 01.03.1985.

3. The counsel appearing for the assessee submitted that the Income Tax Department had served a Prohibitory Order u/s 281B and subsequently notice u/s 226(3) prohibiting Sri K.L.Srihari from paying the principal as well as the interest to the assessee. In view of this, Sri K.L.Srihari had written a letter dated 01.03.1985 to the assessee stating that no interest would be paid to the assessee till such time prohibitory orders were in force. As a result, the assessee had not received any interest from Sri K.L.Srihari till date and hence not taxable.

4. The learned counsel for the Revenue submitted that the attachment did not make any difference in respect of accrual of interest. The attachment was for a short period and the assessee had not foregone the right to receive principal as well as interest from Sri K.L.Srihari.

5. We heard the counsel. We have perused the materials and also the letter written by Sri K.L.Srihari on 08.03.1985 to the assessee which reads as under:

> "M/s.Sujatha Films Private Ltd.,
> 27, Wallace Garden,
> III Street,
> Madras-600 006.
>
> Dear Sirs,
>
> Sub: Loan taken from you and interest payable thereon – reg.

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Ref: Letter from Income-tax Officer, Company Circle IV (1), Madras dt.25.2.1985 Your letter dt.1-3-1985 -

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Please refer to your letter cited above. In continuation of the discussion I had with you on the above subject, this is to confirm that henceforth no interest is payable by me on the balances due to you from 1-3-1985 and you will not be charging any interest.

Thanking you,

Yours faithfully,

sd/-

(K.L.SRIHARI)"

It is clear from the above letter that Sri K.L.Srihari had discussed the matter relating the attachment of the amount or the loan taken by him. Obviously after attachment, Sri K.L.Srihari could not pay the interest as well as principal to the assessee company and after discussion, Sri K.L.Srihari had written that no interest was payable by him on the balance due to the assessee from 01.03.1985. This letter was written because the amount receivable by the assessee from Sri K.L.Srihari stood attached by the Income Tax Department and Sri K.L.Srihari could not have paid a single paisa to the assessee after attachment by the Income tax Department under Section 226(3) of the Income Tax Act. The said letter dated 08.03.1985 written by Sri K.L.Srihari did not prevent the accrual of interest according to the provisions of law. The assessee was aware of the fact that the accrual of interest was not effected by the letter dated 08.03.1985 and that was why the assessee company had not taken any legal action against Sri K.L.Srihari because in so far as attachment under Section 226(3) by the Assessing Officer continue, Sri K.L.Srihari could not pay interest to the assessee. The assessee had given advance to Sri K.L.Srihari and had obtained pronote from him. The assessee company was maintaining the accounts by following the mercantile system of accounting. Under the mercantile system of accounting, income is liable to be taxed on the basis of its accruing or arising to the assessee. In the mercantile system of accounting, accrual of income is independent of its receipt. So long as the amount is due to the assessee, the system of accounting would envisage the amount being treated as having accrued to the assessee. The profit or loss at the end of the accounting year is based not on the difference between what was actually paid out, but on the difference between the right to receive and the liability to pay. If the income has accrued earlier and the assessment treats it as taxable during the year of accrual, it is not open to the Revenue to treat it as an income in the year of receipt in a case where the assessee follows the mercantile basis

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of accounts. In the case of Morvi Industries Ltd. Vs. C.I.T. reported in 82 ITR 835, the Supreme Court held that the interest accrues when it becomes due. The moment the interest accrues, the assessee gets vested right with the right to claim that amount eventhough it may not have been immediately received. The fact that the amount is not subsequently received would also not depart from the fact of accrual. Once the assessee follows mercantile system of accounting, the interest accrues on day to day basis. It is clear that interest on loan or advance to Sri K.L.Srihari had accrued to the assessee even if the amount payable by Sri K.L.Srihari had been attached by the Income Tax Department under Section 226(3) of the Act. The attachment under Section 226(3) by the Income Tax Department did not prohibit accrual of income to the assessee. As and when the the amount is realised by the Income Tax Department from Sri K.L.Srihari, the assessee will get credit for that amount in respect of taxes paid by the assessee. Hence there was accrual of interest and the same is taxable.

6. The second question of law is only for the assessment year 1988-89. In respect of question No.2, the facts are as follows:

For the said assessment year, the assessee was served notice under Section 139(2) on 7.10.1988, but no return was filed in compliance therewith. Later a notice under Section 142(1) was served on 12.7.1990 again calling for the return. The assessee responded to this notice by filing the return on 13.08.1990. The assessment was completed with reference to this return on 18.03.1992. Aggrieved by the order, the assessee filed an appeal before the Commissioner of Income Tax (Appeals) and contended that the assessment was time-barred as it should have been completed before 13.08.1991 i.e., within one year from the date of filing the return, the time limit prescribed under Section 153(1)(c) of the Income Tax Act. The Commissioner of Income Tax (Appeals) rejected the contention holding that this being a case of concealment, the time limit for completion of assessment was eight years. Aggrieved by the order of the C.I.T. (A), the assessee filed an appeal before the Income Tax Appellate Tribunal. The Income Tax Appellate Tribunal submitted that the Assessing Officer had not, before the expiry of the normal time, issued any notice u/s 271(1)(c) nor made known his intention to avail of the extended time and as such was not entitled to make the assessment after the expiry of one year from the date of receipt of the return. The Tribunal had however not accepted the assessee's contention. The Tribunal held that the provisions of Section 153 have been substituted by the Finance Act 1989 and that the amended provisions of Section 153(1)(b) are applicable to the assessment year 1988-89.

7. The learned counsel for the assessee submitted that notice under Section 139(2) was served on the assessee on 7.10.1988, but no return was filed by the assessee. Subsequently, notice under Section 142(1) was served on the assessee on 12.07.1990 for which he filed a return of income on 13.08.1990. The learned counsel for the assessee further submitted that the assessment should have been completed by 13.08.1991 i.e., within

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one year from the date of filing the return, whereas the assessment was completed on 18.03.1992 which was barred by limitation. The learned counsel for the Revenue submitted that under the amended provisions of Sec.153(1)(b), the time limit is one year from the end of the financial year in which a return or a revised return relating to the assessment year commencing on the 1st day of April 1988, or any earlier assessment year is filed under sub-sec.(4) or sub-sec.(5) of Section 139, whichever is later. The provisions of Section 153 have been amended by the Finance Act, 1989 and as per the amended provision, the time limit is one year from the end of the financial year in which the return of income or a revised return of income is filed by the assessee.

8. We heard the counsel. The assessee had filed return of income on 13.08.1990 which was relevant to the financial year ending 31.03.1991. The time limit for completion of the assessment expired on 31.03.1992 i.e., one year from the end of the financial year 31.03.1991. In this case, the assessee had filed Return of income on 13.08.1990 which was relevant for the financial year 01.04.1990 to 31.03.1991. Since the assessee had filed Return of income on 13.08.1990, the Assessing Officer could complete the assessment upto 31.03.1992 and since the assessment order in this case was passed on 18.03.1992, the same was not barred by limitation. The provisions of Section 153(1)(b) are reproduced below:

> "153(1) No order of assessment shall be made under Sec.143 of section 144 at any time after the expiry of -
>
> a) ------
>
> b) one year from the end of the financial year in which a return or a revised return relating to the assessment year commencing on the 1st day of April 1998, or any earlier assessment year, is filed under sub-sec. (4) or sub-sec.(5) of section 139, whichever is later"

The provisions of Section 153 have been substituted by the Finance Act, 1989 and the provisions of Sec.153(1)(b) are applicable for the relevant assessment year. The Assessing Officer issued notice under Section 139(2) and no return of income was filed by the assessee for the said assessment year within the time allowed under Section 139(2). The returns were filed under Section 139(4) and for such a return, the provisions of Sec.153(1)(b) are applicable and time for completion of assessment was to be computed from the end of the financial year in which the return or revised return relating to the assessment years 1988-89 and 1989-90 or any earlier assessment year is filed under sub-sec.(4) or sub-sec.(5) of sec.139. In this case, the ITO had issued notices under Section 139(2) on 30.09.1988 for the assessment year 1988-89 the return filed by the assessee could not be considered as return filed under Section 142(1) because once notice under Section 139(2) was issued by the Assessing Officer calling for return of income for the assessment year 1988-89, the Assessing Officer does not have power to call for the return income under Section 142(1). In this case the return of income filed by the assessee on 13.08.1990 falls under 139(4) and the provisions of

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Section 153(1)(b) which were substituted by Finance Act, 1989 came into operation. The assessment order passed by the Assessing Officer was not barred by limitation because one year was to be counted not from the date of filing the return but from the end of the financial year in which the return relating to the assessment year 1988-89 or earlier assessment year was filed under Sub-Section (4) or Sub-Section (5) of Section 139. The time available with the Assessing Officer for completion of the assessment was upto 31.03.1992 because the assessee had filed the return of income on 13.08.1990 during the financial year 01.04.1990 to 31.03.1991 for the assessment year 1988-89 and one year was available to the Assessing Officer from the end of 31.03.1991 for completing the assessment under Section 153(1)(b). The assessment for the assessment year 1988-89 was completed on 18.03.1992 before the limitation date of 31.03.1992. So, the assessment completed by the Assessing Officer was not barred by limitation. In this case, the return was filed on 13.08.1991 and the assessment year completed on 18.02.1992. Hence, the Tribunal was right in applying the provisions of Section 153(1)(b) and holding that the assessment was not barred by limitation. So far as the amended provision of Section 153(1)(b) is concerned, it is only a procedural provision. Amendment to the procedure has to be applied for all the proceedings which are pending. In the case of Commissioner of Wealth Tax Vs. Sharvan Kumar Swarup and Sons reported in 210 ITR 886, the Supreme Court held as follows:

> "Procedural law, severally speaking is applicable to pending cases. No suitor can be said to have a vested right in procedure."

9. In view of the foregoing conclusions, we find no error or infirmity in the order of the Tribunal and the same does not requires interference. Hence, we answer the both the questions of law referred to us, against the assessee, in favour of the Revenue. No costs.

Sd/-
Asst. Registrar.

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Sub Asst. Registrar.

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To
1. The Assistant Registrar,
The Income Tax Appellate Tribunal,
Rajaji Bhavan, III Floor,
Besant Nagar, Madras 90.(5 copies)

2. The Secretary,
Board of Direct Taxes,
New Delhi.(3 copies).

3. The Commissioner of Income Tax,
Central I, Chennai.

4. The Commissioner of Income Tax,
(Appeals) IV, Madras 34.

5. The Assistant Commissioner,
Central Circle I (1), Madras 34.

+ 1 CC to Ms.Pushya Sitaraman, Advocate SR NO 8490

+ 1 CC to Mr.Srinath Sridevan, Advocate SR NO 8321

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